No. 10-859

In The Supreme Court of the United States

DEBORAH J. PRUNTY, *et al.*,

Petitioners,

v.

ROY M. TERRY, JR., CHAPTER 7 TRUSTEE,

Respondent.

On Petition for a Writ of Certiorari to the
United States Court of Appeals
for the Fourth Circuit

PETITIONERS' REPLY BRIEF

Ann M. Callaway
Counsel of Record for Petitoners
Ann M. Callaway, P.C.
15 Garrett Street
Warrenton, Virginia 20186
(540) 349-4100
(540) 347-1086 (fax)
VSB #29014

LANTAGNE LEGAL PRINTING
801 East Main Street Suite 100 Richmond, Virginia 23219 (800) 847-0477

ISSUES RAISED BY RESPONDENT'S BRIEF IN OPPOSITION

I. Whether it was necessary for the Virginia court to have made a specific finding that the subject property was Prunty's "separate property" before the Bankruptcy Court was required to adhere to Virginia law limiting the rights of a debtor to his ex-spouses separate property?

II. Whether that part of § 20-107.3 (C) of the Code of Virginia, which requires a Final Divorce Decree to be recorded and indexed in the land records *if that Decree divides or transfers marital property*, is irrelevant if the parties have previously executed and recorded a deed transferring the property prior to the date the Final Decree is entered?

III. Whether application of *res judicata* in this case violates the Chapter 7 Trustee's due process rights?

IV. Whether the lower courts' rulings properly honor Virginia law?

V. Whether the trustee is relying on circular reasoning to establish the invalidity of the quitclaim deeds signed by debtor?

LIST OF PARTIES TO THE PROCEEDING

Petitioner

Deborah J. Prunty, in her individual capacity and as the Trustee of the Deborah J. Prunty Revocable Trust

Respondent

Roy M. Terry, Chapter 7 Trustee

Debtor

Richard D. Paschall, Debtor

TABLE OF CONTENTS

Issues Raised in Respondent's Brief in Opposition i

Table of Authorities iii

Argument 1

Conclusion 11

TABLE OF AUTHORITIES

State Cases

Papuchis v. Papuchis, 2 Va.App. 130, 132, 341 S.E.2d 829, 831 (1986). 7

Rogers v. Rogers, 512 S.E.2d 821, 257 Va. 323 (Va., 1999) 9

Federal Cases

Schlossberg v. Barney, 380 F.3d 174 (4th Cir., 2004) 3

State Statutes

§ 20-107.3 of the Code of Virginia, 1950, as amended 1, 7

ARGUMENT

I. *There is no requirement that the Virginia court must have previously made a specific finding that the subject property was Prunty's "separate property" in order to trigger the requirement that the Bankruptcy Court abide by Virginia law limiting the rights of a debtor to his ex-spouse's separate property.*

The Bankruptcy Court is required to follow Virginia law to determine debtor's interest in the subject property. This statement of law is undisputed.

The Virginia law that defines debtor's interest in property in this case is the Virginia equitable distribution statute and Virginia real estate law. The former is codified in § 20-107.3 (C) of the Code of Virginia. This statute defines marital property, separate property, and part-marital/part-separate property. It also defines each spouse's interest in each type of property.

Thus, regardless of whether the Virginia divorce court specifically found that the subject property was Prunty's separate property, the Bankruptcy Court was required to apply the Virginia Equitable Distribution Statute to determine debtor's interest in property acquired by Prunty prior to the marriage.

II. *§ 20-107.3 (C) of the Code of Virginia, which requires a Final Divorce Decree to be recorded*

and indexed in the land records if that Decree divides or transfers marital property, is irrelevant to the facts of this case.

The Final Decree of Divorce in this case did not divide or transfer marital property. The title to the subject property had already been transferred by quitclaims deeds executed and recorded approximately a month before the Final Decree of Divorce was signed by the judge.

The purpose of the Virginia statute (requiring recordation of a divorce decree) is to insure that third parties are on notice of changes in ownership of real property after a divorce has taken place. In some cases, parties do not enter into written agreements prior to their divorce trials. In some cases, deeds are not signed and recorded prior to their divorce trials. In those other cases, a judge has to listen to the evidence, apply the Equitable Distribution Statute, and then divide the property. If the judge orders that one spouse must transfer title to real property to the other spouse, and if this language is in the Final Decree, then the Decree must be recorded to put third parties on notice.

However, as any title examiner will tell you, the best and most accepted way of transferring title to real estate, and for putting third parties on notice, is to execute and record a deed. That is the point of the having the collection of land records in every county

courthouse; to put everyone on constructive notice of who owns what.

Thus, even though it might be necessary to record a Final Decree of Divorce in some cases, it was not necessary in this case. It would have been superfluous and pointless because debtor had already signed quitclaims deeds and those deeds had been recorded. There was no better way that debtor and Prunty could have put third parties on notice of the transfer of title to the subject property.

The trustee's attempt to rely on this part of the Equitable Distribution Statute is, at best, due to his unfamiliarity with Virginia divorce and real estate law and procedure; at worst it is a red herring intended to avoid dealing with the reality that valid quitclaim deeds had been recorded and that third parties were on notice of the change in ownership as of the date of recordation and prior to the date of divorce.

III. Application of res judicata in this case does not violate the Chapter 7 Trustee's due process rights.

The trustee has no greater rights in property than does the debtor.[1] This means that the trustee is

---

[1] *Schlossberg v. Barney*, 380 F.3d 174 (4th Cir., 2004): "However, bankruptcy recognizes state property rights, and filing bankruptcy cannot give a debtor a greater

bound by prior determination of property rights whether he likes them or not. Trustee has no right to a "do-over" simply because he prefers a different result.

Admittedly, the divorce case involved issues not shared by the bankruptcy case; and vice versa. But, the specific issue of the debtor's rights in the subject property is identical to both. This issue has been resolved by the Virginia court; and the Bankruptcy Court is bound by this aspect of the Virginia divorce decree.

It is no help to the trustee that he was not a party in the divorce case. He stands in debtor's shoes in this case and is the same person for the purpose of analyzing whether collateral estoppels applies.

The best analogy on trustee's claim that being bound by the Final Decree of Divorce denies him his due process right is the "eggshell skull" victim in a negligence case. This common law principle holds that a Defendant must take his victim as Defendant finds him. It is no defense that the victim is more sickly or fragile than other victims.

In our case, the trustee must take the debtor as he finds him. The trustee is bound by debtor's legal

---

interest in an asset than that which he owned pre-bankruptcy."

rights to property debtor owns and debtor's lack of legal rights to property that debtor does not own.

Thus, if state law dictates that a debtor has no interest in property because the property was owned by the debtor's spouse prior to their marriage, or because debtor transferred any interest to a spouse in a written agreement, then the trustee has no rights to the same property. The trustee only stands in the shoes of the debtor. If a deed is enforceable against the debtor, it is enforceable against the trustee. If a written agreement is enforceable against the debtor, it is enforceable against the trustee.

If anyone has been denied due process, or will be denied due process if the rulings of the lower courts are upheld, it has been Prunty. As it stands now, she and debtor divided all their property by agreement; she held up her end of the deal by paying debtor what she agreed to pay; debtor (ultimately) held up his end by signing the deeds; the state court incorporated the agreement into the divorce; and their marriage was over. The debtor spent all his money, incurred new debt, and then filed bankruptcy. Now, the trustee wants to sell the property transferred to Prunty in the agreement and keep half the money.

If the terms of a Marital Agreement incorporated into a Final Decree of Divorce can be ignored by a

Bankruptcy Court, then is the Bankruptcy Court going to vacate the Final Decree of Divorce and re-try the divorce case, which will include re-dividing all the marital property that is left? If not, Prunty has been denied her day in court. She would be entitled to prove to the Bankruptcy Court why all the remaining property (not spent on wine, women and song by debtor) is her separate property.

By giving full faith and credit to the Virginia Final Decree of Divorce in the issue of debtor's interest in the real property (collateral estoppels), the Bankruptcy Court is spared the task of re-trying the equitable distribution aspect of a state court divorce case in a post-divorce bankruptcy case where a trustee is trying to undo property division in a divorce. This seems a compelling reason for applying full faith and credit in this context.

IV. The lower courts' rulings do not properly honor state law.

The lower court's rulings completely ignore Virginia law as follows:

They ignore Virginia law defining a debtor's interest in property owned by the parties during a marriage.

They ignore Virginia law defining separate property and limiting the rights of a non-owning spouse to the other spouse's separate property.

They ignore Virginia law defining the legal effect of holding title by tenants by the entireties.

They ignore Virginia law establishing constructive notice to third parties by recording a deed in the land records.

They ignore Virginia law distinguishing between cases where title to property is transferred by a court order from cases where title is transferred by deed.

They consistently cite the trustee's erroneous statement of law that each spouse is "presumed to have a one-half interest in marital property." This is absolutely false, as shown by the wording of the Equitable Distribution statute.[2]

The consistently repeat the trustee's erroneous statement of law that it is presumed that Prunty "made a gift to debtor of a one-half undivided interest in the subject property to debtor." This is flatly contradicted by statute.[3]

---

[2] "Under settled principles, Virginia law does not establish a presumption of equal distribution of marital assets." *(Emphasis added.) Papuchis v. Papuchis*, 2 Va.App. 130, 132, 341 S.E.2d 829, 831 (1986) (Emphasis in original).

[3] § 20-107.3 (A)(3)(h). Subdivisions A 3 d, e and f of this section shall apply to jointly owned property. No presumption of gift shall arise under this section where (i) separate property is commingled with jointly owned

The bankruptcy courts are required to use Virginia law to determine debtor's interest in the subject property. If that had been done in this case, the inevitable conclusion is that debtor has no interest in the property and the trustee's Complaint must be dismissed.

V. *The trustee is relying on circular reasoning to establish the invalidity of the quitclaim deeds signed by debtor.*

The timing of the events in this case is critical to reaching a correct conclusion about the legal effect of the quitclaim deeds and final decree of divorce.

Prior to the date the quitclaim deeds were signed, the parties held title as tenants by the entirety. Under Virginia law, as long as title is held as T/E, no creditors of only one spouse can put any lien on the property. [4]

---

property; (ii) newly acquired property is conveyed into joint ownership; or (iii) existing property is conveyed or retitled into joint ownership. (Emphasis added.) For purposes of this subdivision A 3, property is jointly owned when it is titled in the name of both parties, whether as joint tenants, tenants by the entireties, or otherwise.

[4] "It is settled that tenancies by the entirety are based upon the same four unities that support joint tenancies, that is, the unities of title, estate, time, and possession. However,

Debtor signed the quitclaim deeds in August, 2006. The deeds were recorded shortly thereafter. The legal effect of recording those deeds was (1) to put the world on constructive notice of the change in ownership of the property; and (2) to transfer fee simple title straight to Prunty. Debtor never got any interest in the property that his creditors could encumber.

Then, the Final Decree if Divorce was signed on September 13, 2006. The legal effect of the Final Decree on the title to the real estate was zero. The Final Decree did not transfer title. The quitclaim deeds had already accomplished the transfer of title about a month before.

In his Response to Prunty's Petition, trustee reasons as follows: *If* the transfers (quitclaim deeds) are avoided, the deeds are of no effect. *If* the deeds are of no effect, then the Final Decree of Divorce

---

it is also settled that tenancies by the entirety are supported by a fifth unity which they do not share with any other tenancy: the unity of marriage. That unity embodies the legal fiction that husband and wife are one. And it leads to the result that neither husband nor wife can by his or her sole act defeat the survivorship interest of the other spouse. Neither spouse can by separate act make an absolute disposition of property they hold as tenants by the entirety, nor can a judgment lien creditor of one spouse subject that property to the satisfaction of his lien." *Rogers v. Rogers*, 512 S.E.2d 821, 257 Va. 323 (Va., 1999).

converted the T/E to a tenancy in common, which, in turn, resulted in an interest in the property to which claims of debtor's creditors could attach. *If* the deeds were void and *if* the T/E was converted to a tenancy in common, this would give the trustee the right to avoid the transfers.

In other words, the trustee argues that the deeds are void because they will be void *if* he is successful in his suit to avoid the deeds. And *if* the deeds are void, then, title to the property would be converted to a tenancy in common, which would give the debtor's creditors rights in the property.

The flaw in the trustee's reasoning is that his whole argument hinges on "if" · the premise that the deeds are "avoided." However, the trustee cannot wish away the validity of the deeds. The trustee gives no reason for the invalidity of the deeds other than they are "avoided" because they are void. This is circular reasoning.

If the trustee has any rights in the property, by standing in the debtor's shoes, he must have those rights based on what happened, not by assuming other facts, not by arguing "if."

The quitclaim deeds are not void. They were and are valid transfers of property and their legal effect cannot be wished away by the trustee.

CONCLUSION

For these reasons, Petitioners respectfully request issuance of a writ of certiorari to the United States Court of Appeals for the Fourth Circuit.

Respectfully submitted,

Ann M. Callaway
Counsel for Petitioners
Ann M. Callaway, P.C.
15 Garrett Street
Warrenton, VA 20186
(540) 349-4100
(540) 347-1086 fax
VSB #29014